Supreme Court, U.S.
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No. 93-1463

In the Supreme Court of the United States

OCTOBER TERM, 1993

SOUTHWESTERN BELL TELEPHONE COMPANY,
PETITIONER

v.

FEDERAL COMMUNICATIONS COMMISSION
AND UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether petitioner had adequate notice of the standards that the Federal Communications Commission would apply to petitioner's proposed tariff filing.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-17a) is reported at 10 F.3d 892. The order of the Federal Communications Commission on remand (Pet. App. 18a-30a) is reported at 8 F.C.C. Rcd. 2261. The Commission's initial memorandum opinion and order (Pet. App. 33a-69a) is reported at 7 F.C.C. Rcd. 2906. The order of the Commission's Common Carrier Bureau (Pet. App. 71a-81a) is reported at 6 F.C.C. Rcd. 2089.

JURISDICTION

The judgment of the court of appeals was entered on December 17, 1993. Pet. App. 1a. The petition for a writ of certiorari was filed on March 17, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Until recently, the Federal Communications Commission (FCC or Commission) regulated interstate telephone access rates under a rate-of-return system. Under that system, telephone companies recovered their costs plus a designated rate of return on their investment. Because the system permitted companies to set rates that were designed to recover their costs plus a designated return on investment, it gave companies no incentive to operate efficiently. See *Policy and Rules Concerning Rates for Dominant Carriers*, 3 F.C.C. Rcd. 3195, 3218-3219 (¶ 38), 3222 (¶ 43) (1988).

On October 4, 1990, the Commission announced its decision to replace the rate-of-return system with a "price cap" system for the access rates of the largest local exchange carriers (LECs), of which petitioner is one. *Policy and Rules Concerning Rates for Dominant Carriers*, 5 F.C.C. Rcd. 6786 (1990) (*LEC Price Cap Order*), recon. denied, 6 F.C.C. Rcd. 2637, further recon. dismissed, 6 F.C.C. Rcd. 7482 (1991), aff'd *sub nom. National Rural Telecom Ass'n* v. *FCC*, 988 F.2d 174 (D.C. Cir. 1993). In the order announcing that decision, the *LEC Price Cap Order*, the Commission explained that the price cap system would give LECs an incentive to operate efficiently. Under the new system, the Commission would accord a presumption of lawfulness to interstate access rates that fell at or below a price cap and within specified pricing bands for groups of services known as "baskets." *LEC Price Cap Order*, 5 F.C.C.

Rcd. at 6788 (¶¶ 11-12). The new system would allow an efficient LEC "to retain reasonably higher earnings than would be available under the former [rate-of-return] system." *Id.* at 6787 (¶ 2).

The Commission stated in the *LEC Price Cap Order* that the price cap system would take effect on October 31, 1990. The Commission also ordered the LECs to file their first price cap tariffs by November 1, 1990, with an effective date of January 1, 1991. *LEC Price Cap Order*, 5 F.C.C. Rcd. at 6837 (¶ 413). Further, the Commission determined that initial price caps would be fixed by reference to the LECs' access rates as of July 1, 1990. The Commission explained that it chose a "historical date, as opposed to a prospective one," to prevent LECs "from engaging in * * * price increases in the period leading up to price caps." *Id.* at 6814 (¶ 231).

The new price cap system would induce greater productivity only if the LECs could not easily circumvent or increase their price caps. For that reason, the Commission limited the means by which LECs could obtain upward adjustments of their caps. First, an LEC could adjust its cap upward if it proved that its annual profit level had fallen below 10.25%, the most recent rate of return the FCC had prescribed. *LEC Price Cap Order*, 5 F.C.C. Rcd. at 6788 (¶ 10), 6806-6807 (¶¶ 164, 165); 47 C.F.R. 61.45(d)(1) (vii). Second, an LEC could increase its cap by proving that it had incurred certain kinds of exogenous costs—*i.e.*, certain costs over which it had no control. *LEC Price Cap Order*, 5 F.C.C. Rcd. at 6807-6810 (¶¶ 166-190); 47 C.F.R. 61.45(d)(1). Third, an LEC could increase its cap if it alleged that the price cap rules would not permit it to attract sufficient capital or continue to operate, and if it supported that allegation by cost support data broken down by baskets and a detailed explanation of cost allocation among

services within each basket. *LEC Price Cap Order*, 5 F.C.C. Rcd. at 6823-6824 (¶¶ 300-304); 47 C.F.R. 61.49(e).

2. In accordance with the *LEC Price Cap Order*, petitioner filed its initial price cap tariff on November 1, 1990. The rates in that tariff fell within the cap established by petitioner's July 1990 access rates. Later in November 1990, however, petitioner advised the FCC of its intention to file a proposal to increase its July 1990 rates. In connection with the proposed tariff filing, petitioner requested, and the FCC's Common Carrier Bureau granted, a waiver of 47 C.F.R. 61.38(b)(1), which requires the filing of certain data to support a proposed tariff change, and 47 C.F.R. 61.59, which provides that a new rate may not be changed until it has been in effect for at least 30 days. The Bureau denied, however, petitioner's request for a waiver of 47 C.F.R. 61.58, which prescribes a 45-day notice period before a proposed tariff may become effective. Pet. App. 6a-7a, 50a.

Petitioner filed its proposed tariff revision, Transmittal No. 2051, on December 4, 1990. Petitioner later filed a request (Application No. 257) to submit additional data to justify an even larger rate increase than proposed in Transmittal No. 2051. Under the 45-day notice requirement of Section 61.58, petitioner's proposed rate increase could not take effect until January 18, 1991—more than two weeks after the effective date of petitioner's first price cap tariff. Thus, petitioner's filing, if accepted, would not increase rates for any part of the six-month period between July 1 and December 31, 1990. Its only effect would be to raise petitioner's price cap, and hence the rates that petitioner could charge after January 1, 1991, under the price cap system. Pet. App. 19a, 23a, 33a. Nonetheless, petitioner did not purport to justify its filing under any of the three methods prescribed in the price cap rules for obtaining

an upward cap adjustment. Instead, petitioner merely claimed that its July 1990 rates were too low in light of costs incurred after July 1990.

In April 1991, the Bureau rejected petitioner's proposed tariff filing. The Bureau concluded that "[petitioner's] adjustments to its initial price cap rates and indexes are not allowed by the Commission's price cap regulations and violate the *LEC Price Cap Order*." Pet. App. 71a, 78a. The Bureau reasoned that the *LEC Price Cap Order* did not contemplate adjustments of price caps "to fine tune rates to the authorized [rate-of-return] level," because permitting such adjustments "would have created the kind of incentives the Commission sought to avoid"—incentives for LECs to manipulate their rates on the eve of price cap regulation. *Id.* at 79a. The Bureau also observed that petitioner's post-July 1990 costs did not reflect extraordinary exogenous costs warranting an upward cap adjustment under the price cap rules. *Id.* at 79a-80a. Finally, the Bureau indicated that it would have rejected petitioner's filing even if the rate-of-return system were still in effect, because petitioner had not submitted sufficient data to support its proposed rate increase. *Id.* at 80a; see also *id.* at 70a (dismissing Application No. 257 as moot).

3. The Commission affirmed the Bureau's rejection of petitioner's proposed tariff filing. Pet. App. 33a-34a The Commission, like the Bureau, emphasized that permitting rate increases on the eve of price cap regulation could undermine the incentives provided by the price cap system. To avoid that result, the Commission held that petitioner's proposed rate increase had to satisfy "more stringent criteria than those traditionally prevailing under rate of return." *Id.* at 40a-41a (¶¶ 16-17), 43a (¶ 19). The Commission determined that petitioner's proposal did not meet those criteria. *Id.*

at 44a-47a (¶¶ 21-23). In addition, the Commission observed that "[petitioner's] tariff revisions were not scheduled to become effective until after the changeover to price cap regulation," and that, as the Bureau had concluded, petitioner's application did not satisfy the criteria established under the price cap rules for obtaining an upward cap adjustment. *Id.* at 49a-52a (¶¶ 29-32).

The Commission made a technical adjustment in petitioner's July 1990 rates based on the exclusion of anomalous data from 1986. That adjustment increased petitioner's permissible revenues under the price cap by $6.87 million. Pet. App. 47a-48a (¶¶ 25-26).[1]

4. Petitioner sought review of the Commission's order in the court of appeals. On the Commission's motion, the court remanded the case to the Commission. Pet. App. 8a.

On remand, the Commission reaffirmed its prior decision and clarified the basis for that decision. Pet. App. 19a (¶ 2). The Commission explained that the primary basis for its prior decision was that the Bureau had "correctly rejected" petitioner's proposed tariff filing "as patently unlawful for failing to comply with applicable price cap requirements." *Id.* at 21a (¶ 6); see also *id.* at 25a-26a (¶ 12) ("We reaffirm our earlier conclusion that the Bureau properly applied price cap rather than rate of return regulation to Transmittal 2051."). The Commission determined that because petitioner's proposed tariff filing was "filed after the

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[1] Commissioner Barrett concurred in the technical adjustment but dissented from the rest of the Commission's decision on the basis of his view that "the *LEC Price Cap Order* was not explicit on how mid-course corrections would be treated on the eve of price caps." Pet. App. 67a.

price cap rules became law on October 31, 1990, and b[ore] an effective date later than December 31, 1990, [it] necessarily was subject to the price cap rules rather than rate of return regulation." *Id.* at 22a n.9. The Commission rejected petitioner's claim that it lacked adequate notice that its filing would be subject to the price cap rules rather than rate-of-return criteria. *Id.* at 25a (¶ 11). The Commission also reaffirmed its prior determination that rejection of petitioner's filing would have been required even under rate-of-return criteria. *Id.* at 28a (¶ 16).[2]

6. The court of appeals denied petitioner's petition for review of the Commission's order on remand. Pet. App. 1a-17a. The court began by observing that petitioner did not dispute that it had not justified an increase in its price cap under the price cap rules. *Id.* at 9a n.3. The court identified the "principal issue" raised by petitioner as "whether the FCC provided [petitioner] sufficient notice in the price cap order" that the price cap rules—or, at least, more stringent criteria than obtained under the former rate-of-return system—would apply to proposed rate increases that were to take effect after the effective date of the price cap system established in the *LEC Price Cap Order—i.e.*, January 1, 1991. *Id.* at 9a.

"After careful review," the court found "ample support for the proposition that the price cap rules set forth the exclusive mechanisms for raising price caps to account for actual costs after January 1, 1991." Pet. App. 10a.[3]

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[2] Commissioner Barrett again dissented. Pet. App. 29a-30a.

[3] Because the court held that the *LEC Price Cap Order* gave petitioner adequate notice that its filing was subject to the price cap rules, the court found it unnecessary to address the FCC's alternative conclusion that the filing would have been rejected under rate-of-return criteria. Pet. App. 16a-17a.

The court determined that "[t]he text of the price cap order patently reflects both the FCC's intention to insulate the initial price caps from carrier manipulation and the FCC's recognition that its new regulatory regime creates tremendous incentives for carriers to engage in base-rate maneuvering." *Ibid.* The court rejected petitioner's argument that, in light of "isolated" references to "mid-course corrections" in the price cap order, it lacked "adequate notice that traditional mid-course corrections would cease after January 1, 1991." *Id.* at 13a. The court also rejected petitioner's contention that the Commission's adjustment in petitioner's price cap to account for anomalous 1986 data "belie[d] the Commission's argument that the price cap rules provided the exclusive means by which to raise the price cap." *Id.* at 14a.

ARGUMENT

Petitioner contends that the court of appeals erred in holding that the *LEC Price Cap Order* gave it adequate notice that its proposed tariff filing was subject to the price cap rules. That contention does not warrant further review. The court of appeals merely applied the principles of fair notice enunciated in its precedent to the facts of this case. Petitioner does not, and cannot, contend that those principles conflict with any decision of this Court or that of any other court of appeals.

1. Petitioner argues (Pet. 9-17) that the court of appeals violated the principle of *SEC* v. *Chenery Corp.*, 332 U.S. 194 (1947). That argument is without merit.

a. The *Chenery* principle is not implicated here. *Chenery* stands for the "well established" principle that "an agency's action must be upheld, if at all, on the basis articulated by the agency itself." *Motor Vehicle Mfrs. Ass'n* v. *State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29,

50 (1983) (citing, *inter alia*, *Chenery*, 332 U.S. at 196); see also *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156, 168-169 (1962). The agency action at issue here was the Commission's decision to apply the price cap rules to petitioner's proposed tariff filing.

Petitioner's challenge in the court of appeals focused not on the reasonableness of the Commission's decision to apply its price cap rules, but rather on whether petitioner had adequate notice that the price cap rules would be applied. Pet. App. 9a. The court accordingly emphasized in reviewing petitioner's challenge: "[W]e do not examine the reasonableness of the Commission's intended interpretation [of its *LEC Price Cap Order*], but simply evaluate 'the clarity with which the agency made that interpretation known.'" *Ibid.* (quoting *McElroy Elecs. Corp.* v. *FCC*, 990 F.2d 1351, 1358 (D.C. Cir. 1993)).

The resolution of petitioner's challenge depended not on an application of the *Chenery* principle, but on an application of principles of fair notice of agency action. In accordance with its precedents regarding fair notice, the court independently examined the price cap order to determine whether a "fair reading" of it gave petitioner notice that the price cap rules would apply to its proposed tariff filing. See, *e.g.*, *McElroy Electronics*, 990 F.2d at 1358; *Maxcell Telecom Plus, Inc.* v. *FCC*, 815 F.2d 1551, 1558 (D.C. Cir. 1987); *Bamford* v. *FCC*, 535 F.2d 78, 82-85 (D.C. Cir.), cert. denied, 429 U.S. 895 (1976).

Nothing in *Chenery* barred the court from making such an independent assessment. In particular, the court was not limited to reviewing the portions of the price cap order that the FCC relied upon when it rejected petitioner's fair-notice argument in its initial order and its order on remand in this case. As the court explained, "[a]lthough the agency's interpretation of its

own orders is ordinarily entitled to deference, [a court must] pay strict heed to whether the agency provided affected parties with full notice of the *content* of those interpretations." Pet. App. 9a-10a.

In sum, *Chenery* did not require the court of appeals to limit its inquiry to the agency's explanation of why its price cap order provided adequate notice that the price cap rules would apply to petitioner's proposed tariff filing. Instead, the court was required, under its precedents regarding fair notice, independently to determine whether the price cap order gave adequate notice of the applicability of the price cap rules. Petitioner does not, and cannot, contend that the principles of fair notice established by the D.C. Circuit, and applied here, conflict with *Chenery* or with the decisions of any other court of appeals. Further review is therefore not warranted.[4]

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[4] Petitioner argues (Pet. 13-15) that certain statements by the Commission in its initial order and its order on remand in this case undermine the court of appeals' conclusion that the *LEC Price Cap Order* gave petitioner adequate notice of the applicability of the price cap rules. The statements upon which petitioner relies, however, were made long after petitioner filed its proposed rate increase. Consequently, those statements could not have influenced petitioner's understanding of what the *LEC Price Cap Order* meant "at the time the [price cap] order was issued." *McElroy Elecs.*, 990 F.2d at 1358. The court of appeals has correctly recognized that, in cases involving fair-notice claims, "the contents of the order itself are the most important consideration." *Id.* at 1362. Here, the court of appeals properly focused on the contents of the *LEC Price Cap Order* in deciding whether that order provided fair notice. As discussed *infra*, p. 15, the court also considered statements in the Commission's subsequent orders insofar as they were relevant to determining whether the price cap order provided adequate notice.

b. In any event, even if the *Chenery* principle did apply here, the court of appeals did not violate it.

i. Contrary to petitioner's claim (Pet. 10; see also Pet. 13-14), the court of appeals did not improperly rely "on arguments and explanations that appeared for the first time in the FCC's appellate counsel's brief" in holding that petitioner had adequate notice that its proposed tariff filing was subject to the price cap rules. Petitioner bases that claim (Pet. 13-14) on the fact that both the court of appeals and the FCC's brief on appeal relied on paragraph 245 of the *LEC Price Cap Order* in addressing the notice issue. But the Commission itself relied upon paragraph 245 in concluding that petitioner had adequate notice. Pet. App. 19a-20a n.4. Thus, petitioner is wrong in suggesting (Pet. 13) that paragraph 245 was raised "for the first time" in the FCC's appellate brief.[5]

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[5] Petitioner attempts (Pet. 13) to attach significance to the fact that the court of appeals and the FCC's brief on appeal quoted and discussed paragraph 245 at some length, whereas the Commission merely cited it without discussion. The attention to paragraph 245 at the court of appeals level, however, stems from the fact that the Commission and petitioner disputed its import. Petitioner relied on the single statement in paragraph 245 that "[d]uring the period between the July 1, 1990 date . . . and the January 1, 1991 start date of price cap regulation, LECs remain free to introduce new effective prices justified under existing rate of return cost support requirements." Pet. App. 13a (quoting *LEC Price Cap Order*, 5 F.C.C. Rcd. at 6816 (¶ 245)). Petitioner argued that this statement indicated that its application for a rate increase would be reviewed under rate-of-return criteria. Pet. App. 13a. The court of appeals rejected that argument; it determined that, "rather than support [petitioner's] argument, * * * this statement undermines it," when the statement is read in light of "the avowal" that immediately followed it:

Moreover, as petitioner concedes (Pet. 14), the court of appeals cited many other paragraphs of the *LEC Price Cap Order* to support its conclusion that petitioner had adequate notice. Pet. App. 10a-11a (citing paragraphs 189, 230, 232, 241, and 243 of price cap order). The court's reliance on those other paragraphs, which were not cited in the FCC's brief on appeal, belies petitioner's contention that the court merely accepted appellate counsel's *post hoc* rationalization.

ii. Nor did the court of appeals "substitute [its] assessment of policy considerations" for that of the Commission, as petitioner contends. Pet. 15. Petitioner asserts that the court, and not the Commission, first came up with the rationale that applying the price cap rules to filings like petitioner's would "prevent[] LECs from engaging in pre-price cap 'maneuvering' and 'manipulation' of their costs," Pet. 15, and that "the FCC itself never relied upon that justification," Pet. 16. Those assertions are incorrect.

> [T]o the extent LEC transmittals have the effect of increasing prices for services during this six month period, our decision to inaugurate the price cap index (PCI) on July 1, 1990 and to require actual prices to be equal to or below the PCI on January 1, 1991, prevents LECs subject to price caps from engaging in a rapid escalation in prices that would have the effect of raising their price cap base rates.

Ibid. (quoting *LEC Price Cap Order*, 5 F.C.C. 2d Rcd. at 6816. (¶ 245)). The court of appeals found it "clear" from "the terms of" paragraph 245, read as a whole, that "the Commission did not contemplate that any rate increases occurring during this period would automatically raise the actual price cap for the purposes of the new regulations." Pet. App. 13a. Given the dispute over the meaning of paragraph 245, it was not surprising or improper for appellate counsel and the court to discuss it at some length.

The court of appeals correctly determined that the FCC's anti-manipulation justification for applying the price cap rules was "patently reflect[ed]" in "[t]he text of the price cap order." Pet. App. 10a. The court quoted numerous specific passages from the order that "make abundantly clear the FCC's intention to abandon ordinary mid-course corrections under its new price cap regime." *Id.* at 11a. The court cited the Commission's express recognition "that rational LECs, like [petitioner], would be motivated to elevate their costs to obtain the highest possible price cap if price caps were set prospectively." *Ibid.* The court also cited the Commission's repeated declarations "that it [had] adopted historical rates to avoid the possibility of just such manipulation." *Ibid.* The court found that the Commission's development of three specific mechanisms for upward cap adjustments in the *LEC Price Cap Order* manifested the agency's clear intent "that more rigorous hurdles awaited any attempt to raise prices that might potentially frustrate incentives for efficiency." *Id.* at 12a. Thus, the court properly examined the text of the price cap order with care and correctly found in it "ample support" for the conclusion that the price cap rules provided the exclusive mechanisms for increases in the initial price caps. *Id.* at 10a.[6]

2. The decision below does not involve any issue of broad importance warranting this Court's review.

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[6] As discussed above, p. 9, *supra*, petitioner's challenge in the court of appeals did not focus on whether the FCC adequately justified its decision to apply the price cap rules to petitioner's proposed rate increase, but focused instead on whether the *LEC Price Cap Order* gave petitioner adequate notice of the applicability of the price cap rules. Accordingly, the court of appeals cited the anti-manipulation justification articulated in the *LEC Price Cap Order* to show that the order provided adequate notice.

a. The factual situation involved here will not recur. The LECs subject to the price cap system have completed the transition to that system. Consequently, there is no continuing importance to the question whether affected LECs had adequate notice of what standards would apply to proposed rate increases that were filed during the transition period and that would have the effect of increasing price caps. Moreover, although petitioner asserts (Pet. 17) that it will suffer economic harm from the decision below for years to come, nothing in that decision bars it (or any other affected LEC) from filing a request for an upward cap adjustment that complies with the price cap rules.

b. Petitioner asserts that the court of appeals has "set a dangerous precedent with potentially broad implications" (Pet. 10) by "establish[ing] a dangerously low standard" (Pet. 18) for determining whether an agency has provided adequate notice of the manner in which it interprets its orders. That assertion mischaracterizes the standard that the court of appeals applied.

The court of appeals stated the controlling standard as follows (Pet. App. 9a, quoting *McElroy*, 990 F.2d at 1358):

> elementary fairness requires "not . . . that the agency have made the clearest possible articulation," but "only that, based on a 'fair reading' of its order, the petitioners knew or should have known what the Commission expected of them."

The court explained that "[t]he key factor for our purposes is that the order be 'reasonably comprehensible to [people] acting in good faith.'" Pet. App. 9a (quoting *Maxcell Telecom Plus, Inc.* v. *FCC*, 815 F.2d 1551, 1558 (D.C. Cir. 1987)). Ultimately, the court determined that "the price cap order, fairly read, provided sufficient notice to alert LECs that increases to the July 1, 1990

price cap that were to go into effect after January 1, 1991 could be accomplished only through the three mechanisms set forth in the order." Pet. App. 3a.

The court of appeals did not ignore the passages in the Commission's orders that petitioner claimed to be contrary to the court's reading. The court examined those passages, which referred to "mid-course corrections," with great care. Pet. App. 13a-16a. The court determined that the "isolated" references to "mid-course corrections" in the price cap order did not "have the effect of signalling an intent to preserve the mid-course correction status quo contrary to the basic thrust of the text of the order." *Id.* at 14a. With regard to the reference to "mid-course corrections" in the order on remand in this case, the court determined that, while the reference was "admittedly opaque and even superficially contradictory," it was "most reasonably directed to the [three prescribed] escape mechanisms of the new price cap scheme." *Id.* at 15a-16a.

The court's "careful review" (Pet. App. 10a) of the Commission's orders demonstrates that the court will not "smooth over" (Pet. 18) any inconsistencies in reviewing an agency's decision, as petitioner fears. Moreover, the court warned that "the FCC courts danger when it uses impenetrable, imprecise language." Pet. App. 16a. The court also made clear that its holding was a narrow one, reflecting no more than an application of the notice standard established by its precedents to the facts of this case: "In this particular instance, * * * given the relative clarity with which the price cap order itself mandates rejection of [petitioner's] filing, we find insufficient cause for reversal." *Ibid.*

Petitioner does not challenge the standard underlying the court of appeals' decision or suggest that the standard conflicts with any decision of this Court or that of

any other court of appeals. Petitioner simply disagrees with the application of that standard to the facts of this case. Further review is therefore not warranted.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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